

section 535(c) may be illustrated by the following examples:

Example 1. The X Corporation, which is not a mere holding or investment company, has accumulated earnings and profits in the amount of \$125,000 as of December 31, 1974. Thus, the minimum credit provided by section 535(c)(2) exceeds the accumulated earnings and profits of X by \$25,000. It has earnings and profits for the taxable year ended December 31, 1975, in the amount of \$100,000 and has a dividends paid deduction under section 561 in the amount of \$30,000 so that the earnings and profits for the taxable year which are retained in the business amount to \$70,000. Assume that it has been determined that the earnings and profits for the taxable year which may be retained for the reasonable needs of the business amount to \$55,000 and that a deduction has been allowed under section 535(b)(6) in the amount of \$5,000. Since the amount by which \$150,000 exceeds the accumulated earnings and profits at the close of the preceding taxable year is less than \$50,000 (\$55,000-\$5,000), the minimum credit provided by section 535(c)(2) will not apply and the accumulated earnings credit must be computed under section 535(c)(1) on the basis of the reasonable needs of the business. In this case, the accumulated earnings credit for the taxable year ended December 31, 1975, will be \$50,000 computed as follows:

Earnings and profits of the taxable year determined to be retained for the reasonable needs of the business	\$55,000
Less: The deduction for long-term capital gains (less applicable tax) allowed under sec. 535(b)(6)	5,000
Accumulated earnings credit allowable under sec. 535(c)(1)	50,000

Example 2. The Z Corporation which is not a mere holding or investment company, has accumulated earnings and profits in the amount of \$45,000 as of December 31, 1974; it has earnings and profits for the taxable year ended December 31, 1975, in the amount of \$115,000 and has a dividends paid deduction under section 561 in the amount of \$10,000, so that the earnings and profits for the taxable year which are retained amount to \$105,000. Assume that it has been determined that the accumulated earnings and profits of the taxable year which may be retained for the reasonable needs of the business amount to \$20,000 and that no deduction is allowable for long-term capital gains under section 535(b)(6). The accumulated earnings credit allowable under section 535(c)(1) on the basis of the reasonable needs of the business is determined to be only \$20,000. However, since the amount by which \$150,000 exceeds the accumulated earnings and profits at the close of the preceding taxable year is more than \$20,000, the minimum accumulated earnings credit provided by section 535(c)(2) is applica-

ble. The allowable credit will be the amount by which \$150,000 exceeds the accumulated earnings and profits at the close of the preceding taxable year (*i.e.*, \$105,000, \$150,000 less \$45,000 of accumulated earnings and profits at the close of the preceding taxable year).

(c) *Holding and investment companies.* Section 535(c)(3) provides that, in the case of a mere holding or investment company, the accumulated earnings credit shall be the amount, if any, by which \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year. Thus, if such a corporation has accumulated earnings equal to or in excess of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) at the close of its preceding taxable year, no accumulated earnings credit is allowable in computing the accumulated taxable income. See paragraph (c) of § 1.533-1 for a definition of a holding or investment company. For the accumulated earnings credit of a mere holding or investment company which is a member of an affiliated group which has elected the 100-percent dividends received deduction under section 243(b), see section 243(b)(3) and § 1.243-5. For the accumulated earnings credit of a mere holding or investment company which is a component member of a controlled group of corporations (as defined in section 1563), see sections 1561, 1562, and 1564.

(Sec. 1561(a) (83 Stat. 599; 26 U.S.C. 1561(a)))

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6992, 34 FR 826, Jan. 18, 1969; T.D. 7181, 37 FR 8066, Apr. 25, 1972; T.D. 7244, 37 FR 28897, Dec. 30, 1972; T.D. 7376, 40 FR 42744, Sept. 16, 1975; T.D. 7528, 42 FR 64694, Dec. 28, 1977]

§ 1.536-1 Short taxable years.

Accumulated taxable income for a taxable year consisting of a period of less than 12 months shall not be placed on an annual basis for the purpose of the accumulated earnings tax imposed by section 531. In such cases accumulated taxable income shall be computed on the basis of the taxable income for such period of less than 12 months, adjusted in the manner provided by section 535(b) and § 1.535-2.